Letter of Credit:

International Shipping & Trade

Presented by

FRONTIER Supply Chain Solutions, Inc.

WHAT IS A LETTER OF CREDIT?

A LETTER OF CREDIT IS:

- a)a tool for minimizing risk in international trade;

- b) is essentially a financial contract between a bank, a bank's customer and a beneficiary.

As usual, Letter of Credit **issued by an importer’s bank**, the letter of credit guarantees the beneficiary will be paid once the conditions of the letter of credit have been met.

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WHAT IS THE PURPOSE OF USED IT?

A LETTERS OF CREDIT ARE USED FOR:

- **minimizing risk in international trade transactions** where the buyer and the seller may not know one another; and
- If you are an importer, using a letter of credit can **ensure that your company only pays for goods after the supplier has provided** evidence that they have been shipped; and
- allowing you to **conserve your cash flow**, since you don't have to make any advance payments or deposits to the exporter; and
- providing **instant credibility** with an exporter by demonstrating your creditworthiness.

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WHAT IS THE PURPOSE OF USED IT? (CONTINUE)

A LETTERS OF CREDIT ARE USED FOR:

- If you are an exporter, the letter of credit is **insurance in case the buyer fails to pay for the goods you shipped**. In such a case, the financial institution will cover the amount outstanding. The letter of credit also protects you against legal risks since you are ensured payment as long as delivery conditions have been met; and

- For exporters, a letter of credit can also be **pledged as collateral against working capital loans** to help you fill your order.

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WHO IS INVOLVED?

Normally, the bank's customer is the importer, or the buyer of the goods. They work with the bank to issue the letter of credit to the beneficiary.

The **beneficiary** is the exporter, otherwise known as the seller or supplier of the goods.

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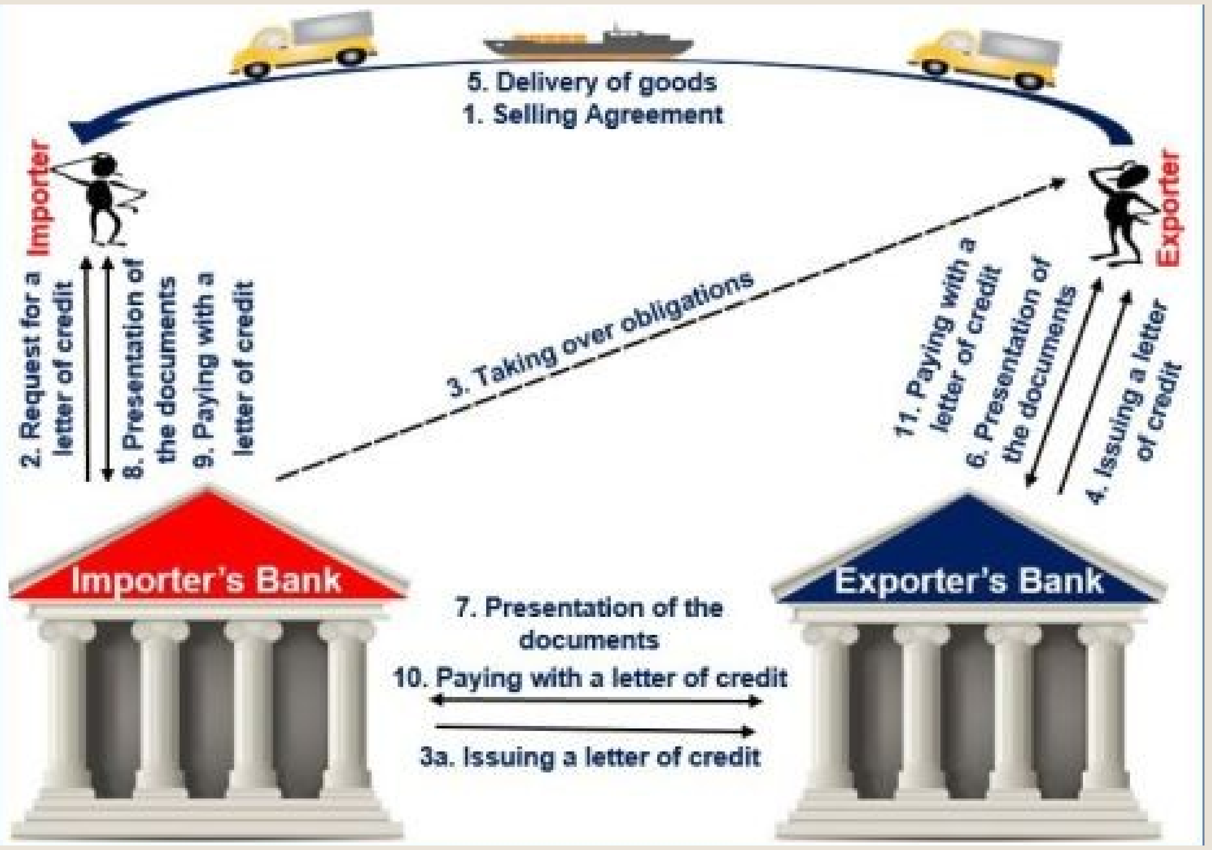
HOW DOES IT WORK?

The letter of credit outlines the conditions under which payment will be made to an exporter.

The **issuing bank** will generally act on behalf of its client (the buyer) to ensure that all conditions have been met before the funds of the letter of credit are released.



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WHAT IS A DISCOUNT RATE?

A letter of credit may have a **discount rate**. In other words, the buyer may not have been the one to close the deal with the seller. Perhaps, it was arranged by a broker or the buyer's agent. In that case, the difference between the actual amount available for purchase and the full value of the letter of credit is the **commission earned by the broker**.

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WHAT IS A BACK-TO-BACK LETTER OF CREDIT?

A **Back-to-back letters of credit** are typically used when a seller has to purchase a component or subcontract part of the manufacturing of a product to a third party, but does not have the cash flow to do so.

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WHAT IS A BACK-TO-BACK LETTER OF CREDIT? (CONTINUE)

In this case, the buyer obtains a letter of credit for the beneficiary (the seller). Once the letter of credit has been received by the seller's bank, the seller can apply with his bank for a second letter of credit of a lesser value. This second letter of credit is sent to the third-party supplier's bank so that the supplier knows that he or she will be paid and can proceed with that part of the transaction.

Back-to-back letters of credit **can also be used to guarantee commission payments to a party acting as an agent for the seller.**

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WHAT IS A LETTER OF GUARANTEE?

If you are a seller dealing with **customers outside of Canada**, they may require you to provide guarantees before doing business with you.

A **letter of guarantee** functions as a guarantee that is equal to a specified percentage of the contract value. If you fulfill your contract, the letter of guarantee expires and the bank returns your collateral. However, if you don't fulfill your contract, your bank will immediately pay the specified amount to your customer.

The letter of guarantee could also **protect you as a seller** in a situation where the buyer is unable to pay you. The bank would then pay you the value of the letter of guarantee.

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Good Job!

QUIZ TIME

Let`s check what you learn in **Quiz**!

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